No. 06-493

In The
Supreme Court of the United States

QUICKEN LOANS, INC.,

Petitioner,

v.

PRESTON DuFAUCHARD,

Respondent.

On Petition For A Writ Of *Certiorari*
To The United States Court Of Appeals
For The Ninth Circuit

BRIEF IN OPPOSITION

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COUNTERSTATEMENT OF THE QUESTIONS PRESENTED

The Alternative Mortgage Transaction Parity Act ("Parity Act")

Respondent disputes Petitioner's assertion that a conflict exists between the Ninth Circuit and Seventh Circuit concerning the preemptive effect of the Parity Act. There is no conflict or question requiring review or resolution by this Court regarding the Parity Act.

The Depository Institutions Deregulation and Monetary Control Act ("DIDMCA")

Respondent also disputes Petitioner's characterization of the holding of the Ninth Circuit opinion below. Therefore, as argued in further detail herein, Respondent believes there is no question requiring review regarding the DIDMCA.

PARTIES TO THE PROCEEDINGS BELOW

The Petitioner below was Quicken Loans, Inc. ("Quicken Loans"). The Respondent below was Wayne Strumpfer, then Acting Commissioner of the California Department of Corporations. Preston DuFauchard is now the Commissioner of the California Department of Corporations ("Commissioner"), and the named Respondent to this Petition.

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RESPONSE TO PETITION FOR A WRIT OF *CERTIORARI*

Respondent prays that this Court deny the petition for a writ of *certiorari* sought by Quicken Loans, Inc.

STATEMENT OF THE CASE

The Commissioner of the Department of Corporations ("Commissioner") is the state official charged with enforcing the California Residential Mortgage Lending Act (Cal. Fin. Code § 50000 *et seq.*) ("CRMLA"), including Financial Code § 50204(o). The CRMLA is a consumer protection law, enacted to protect California consumers in the area of mortgage lending.

California Civil Code section 2948.5[1] and California Financial Code section 50204(o)[2] prohibited lenders licensed under the CRMLA from charging borrowers per diem interest for more than one day prior to the recording of the mortgage or deed of trust. Together they will be

[1] The version of Civil Code section 2948.5 in effect at the time of this dispute (prior to its most recent amendment) provided in pertinent part as follows:

> A borrower shall not be required to pay interest on a principal obligation under a promissory note secured by a mortgage or deed of trust on real property improved with between one to four residential dwelling units for a period in excess of one day prior to recording of the mortgage or deed of trust if the loan proceeds are paid into escrow.

[2] At the time of this dispute, California Financial Code section 50204(o) read in pertinent part as follows:

> A licensee may not . . . [r]equire a borrower to pay interest on the mortgage loan for a period in excess of one day prior to recording of the mortgage or deed of trust.

refe[illegible]d to frequently herein as the "Per Diem Statutes." The statutes have since been amended to prohibit lenders from charging per diem interest for more than one day prior to disbursement of the loan proceeds.

It is undisputed that Quicken Loans is a "nonfederally chartered" lender within the meaning of the Parity Act, and that it is required under the CRMLA to obtain a license from the Commissioner. In its role as regulator of California licensed mortgage lenders, the Department of Corporations began an examination of Quicken Loans in 2001. This resulted in a March 11, 2002 letter to Quicken Loans, noting violations of Civil Code section 2948.5 and Financial Code section 50204(o), the Per Diem Statutes, and demanding compliance. On January 28, 2003, the Department again wrote to Quicken Loans, reiterating its demand for compliance with the Per Diem Statutes.

On February 11, 2003, Quicken Loans filed its original Complaint in U.S. District Court (Eastern District of California), alleging federal preemption of the Per Diem Statutes by DIDMCA and the Parity Act. Quicken Loans subsequently filed a First Amended Complaint, adding a claim for a "taking" under the U.S. Constitution. The district court dismissed the "takings" claim for lack of ripeness. The Ninth Circuit affirmed that dismissal, and the "takings" claim is not a subject of the petition herein.

The district court granted summary judgment against the Commissioner on the DIDMCA preemption claim, and summary judgment against Quicken Loans on the Parity Act claim. Both sides appealed. The Ninth Circuit vacated the summary judgment against the Commissioner on the

DIDMCA claim, and affirmed the summary judgment against Quicken Loans on the Parity Act claim.

REASONS WHY THIS PETITION SHOULD NOT BE GRANTED

I. There is no conflict with the decisions of other United States courts of appeals on the scope of Parity Act Preemption.

Contrary to the assertions of Quicken Loans, there is no "split" between the Ninth Circuit and any other circuit on the scope of the Parity Act's preemption. Quicken Loans mischaracterizes the holding of *Ill. Ass'n of Mortgage Brokers v. Office of Banks and Real Estate*, 308 F.3d 762 (7th Cir. 2002). The issue on appeal in *Ill. Ass'n of Mortgage Brokers* was whether the Home Ownership and Equity Protection Act of 1994 (HOEPA) repealed the Parity Act. *Id.* at 763, 764.

In *Ill. Ass'n of Mortgage Brokers*, the State of Illinois issued regulations to augment HOEPA pertaining to balloon payments, prepayment penalties, and amortization schedules. *Id.* at 764. The Seventh Circuit Court of Appeals found that HOEPA did not repeal the Parity Act. *Id.* at 765, 766. Thus, the regulations issued by the State of Illinois were possibly preempted by the Parity Act to the extent that they blocked state lenders from extending credit on terms available under federal regulations. *Id.* at 768. However, the court did not fully address the issue of conflict preemption and remanded the case to the trial court to decide which of the state regulations, if any, infringed on the Parity Act and the regulations of the Office of Thrift Supervision ("OTS"). *Id.* at 768.

In contrast, in the instant case the Ninth Circuit has held that there was no actual conflict between California's Per Diem Statutes and the OTS regulation on adjustments to loan payments. It is not impossible to comply with both the Per Diem Statutes and the OTS regulation. (Opinion below, Appendix A, p. 8a) Therefore, there is no basis for conflict preemption.

Similarly, Quicken Loans misreads *National Home Equity Mortgage Association v. Face*, 239 F.3d 633 (4th Cir. 2001) to argue that there is a split in authority. The issue in *National Home* was whether a state housing creditor could require and enforce a prepayment fee in a mortgage agreement notwithstanding Virginia's law. *Id.* at 638.

The court found that 12 C.F.R. § 560.220, which specifically addresses prepayment fees, applies and thus the Parity Act preempted Virginia's conflicting law limiting prepayment fees. *National Home*, 239 F.3d at 638, 639. Hence, state housing creditors offering alternative mortgage transactions can use prepayment fee terms, *not* because federally chartered lenders can, but because regulation 12 C.F.R. § 560.220 expressly allows it.[3] *National Home* is a clear case of conflict between the state statute and the federal regulation, something the courts below have specifically held *not* to exist in the instant case.

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[3] In *Black v. Financial Freedom Senior Funding Corp.* 92 Cal.App.4th 917, 934 (2001), the court in analyzing *NHEMA* concurred that the prepayment fee regulation by Virginia was preempted because the fees were specifically identified in 12 C.F.R. § 560.220 and thus applicable to nonfederally chartered housing creditors.

In short, there is simply no conflict between the opinion below and that of any other United States court of appeal, and there is no reason to grant the review on that basis.

II. The decision below is not a departure from the accepted and usual course of judicial proceedings.

A. Claimed Misinterpretation of the Parity Act

Quicken Loans rests its argument on the faulty premise that the Parity Act is intended to create uniform parity between federally and nonfederally chartered lenders. That is simply not the case.

Quicken Loans misinterprets *Ill. Ass'n of Mortgage Brokers*, *supra*, 308 F.3d 762 for the proposition that state lenders should be free to make alternative mortgage transactions on the same terms as federal lenders. That is not the holding of the case and it is not the purpose of the Parity Act. That case specifically held that state regulations are preempted under the Parity Act "to the extent that they block state lenders from extending credit on terms open under federal regulations . . . " *Id.* at 768.

This raises the issue of what federal regulations are applicable to nonfederally chartered lenders. In the Parity Act, Congress directed the OTS, as the federal agency responsible for oversight of housing creditors and the application of the Parity Act to such entities, to "identify, describe, and publish those portions or provisions of their respective regulations that are *inappropriate for (and thus inapplicable to) or that need to be conformed for the use of*, the nonfederally chartered housing creditors. . . . " Section

807 of title VIII of Act of October 15, 1982, (Pub. L. No. 97 – 320; 96 Stat. 1545 (emphasis added) *codified at* 12 U.S.C. § 3801.

In response to this delegation, the OTS promulgated the four regulations that are intrinsic to the ability of housing creditors to offer alternative mortgage transactions.[4] 12 C.F.R. § 560.220; 67 Fed. Reg. 60542, 60545 (2002). The four regulations identified in 12 C.F.R. § 560.220[5] as applicable to nonfederally chartered housing creditors, such as Quicken Loans, are: Imposition of Late Charges (§560.33); Prepayments of Real Estate Loans (§560.34); Adjustments to Home Loans (§560.35); and, Disclosures for Variable Rate Transactions (§560.210). The OTS, addressing these four regulations identified in 12

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[4] At issue in this litigation are the regulations that were in effect at the time the examination was conducted, namely 12 C.F.R. §§ 560.33, 560.34, 560.35 and 560.210. Effective July 1, 2003, sections 560.33 and 560.34 are removed and a housing creditor must comply only with sections 560.35 and 560.210 to make alternative mortgage transactions. 67 Fed. Reg. 60542, 60543, 60544 (2002). In its comments to the regulatory amendments, the OTS reasoned that the repealed regulations were not necessary because they were not adopted to enable federal thrifts to engage in alternative mortgage financing, but for safe and sound fiscal practices. 67 Fed. Reg. 60542, 60544 (2002).

[5] 12 C.F.R. § 560.220 provides:

> Pursuant to 12 U.S.C. 3803, housing creditors that are not commercial banks, credit unions, or federal saving associations may make alternative mortgage transactions as defined by that section and further defined and described by applicable regulations identified in this section, notwithstanding any state constitution, law, or regulation. In accordance with section 807(b) of Public Law 97-320, 12 U.S.C. 3801 note, §§ 560.33, 560.34, 560.35, and 560.210 of this part are identified as appropriate and applicable to the exercise of this authority and all regulations not so identified are deemed inappropriate and inapplicable. . . .

C.F.R. section 560.220, stated "[h]ousing creditors must comply with these requirements to obtain the benefit of the [Parity Act's] preemption of state laws. All other OTS regulations are *inappropriate and inapplicable* to state housing creditors." 67 Fed. Reg. 60542, 60543 (2002) (emphasis added). 12 C.F.R. § 560.220 identifies only those four areas of regulation and states that any regulations "not so identified are . . . inappropriate and inapplicable." As none of these regulations address per diem interest, or when a lender may begin to charge the borrower, they cannot preempt California's laws. Therefore, when the Ninth Circuit held against Quicken Loans, there was no denial of any right to parity. It was a holding consistent with the Parity Act.

Because the OTS was identifying those regulations that are "intrinsic to the ability to offer alternative loans," it cannot be claimed by Quicken Loans that nonfederally chartered lenders may make variable interest home mortgage loans and 'other alternative mortgage transactions' on the *same terms* as federally-chartered lenders. Rather, a plain reading of the Parity Act demonstrates that it does not provide for such an interpretation. The OTS "has never identified its preemption rules as applicable to state housing creditors under AMTPA." 67 Fed. Reg. 60542, 60544 (2002). Where state laws are directed at regulating all mortgage transactions and are not directed at restricting alternative mortgage transactions, the OTS "is reluctant to encroach upon this state authority. . . . " *Id.* The view of OTS here is therefore actually consistent with *Ansley v. Ameriquest Mortg. Co.*, 340 F.3d 858 (9th Cir. 2003) and with *Black v. Fin. Freedom Senior Funding Corp.*, 92 Cal.App.4th 917, 112 Cal.Rptr.2d 445 (2001), upon which the opinion below partly relied for guidance.

In short, the opinion below declined to preempt California's statute precisely because the Per Diem Statutes do not affect a state chartered lender's ability to have the parity with federally chartered lenders that is intended by the Parity Act. On the contrary, the Per Diem Statutes are the type of state law that Congress and OTS expressly declined to preempt. Therefore, the opinion below in no way offends traditional notions of statutory interpretation, and there is no reason to grant the petition on this basis.

B. The Ninth Circuit did not disregard the plain language of DIDMCA.

First, it must be recognized that in its DIDMCA argument, Quicken Loans is not attacking the opinion below, but rather the opinion in *Wells Fargo N.A. v. Boutris*, 419 F.3d 949 (9th Cir. 2005). For in the opinion below, the Ninth Circuit simply held that Quicken Loans had failed to distinguish *Wells Fargo* and the Per Diem Statutes were not preempted by DIDMCA. Although Quicken Loans filed an *amicus* brief in *Wells Fargo*, the Ninth Circuit opinion disagreed with the analysis. This petition is simply another bite at that apple, and presents nothing new. More to the point, there is no departure from the rules of statutory interpretation.

In *Wells Fargo, supra*, the Court emphasized that it was convinced by the First Circuit decision in *Grunbeck v. Dime Savings Bank of New York, FSB*, 74 F.3d 331 (1st Cir. 1996). That decision, and *Wells Fargo* as well, held that the DIDMCA is concerned with only the "rate" and "amount" of interest, not with other features of the interest calculation. In the instant case, that meant DIDMCA is

not concerned with laws regulating when interest can commence, such as the California Per Diem Statutes. Nowhere in the *Wells Fargo* opinion does the Ninth Circuit "deviate from the plain meaning" of the federal statute, as the petition claims. Rather, *Wells Fargo* holds that the Per Diem Statutes do not expressly limit the rate or amount of interest, and therefore are not preempted.

Ironically, the petitioner here argues, as it did below, that the Per Diem Statutes expressly limit to zero the amount of interest that can be charged during a particular time. The irony is that it is petitioners, not the court below, who are looking to the impact of a particular statute, not to its express terms. By their express terms, the Per Diem Statutes deal only with the date upon which interest may begin to be computed, and not at all with either the rate or amount of the interest. In this regard, *Wells Fargo* is wholly consistent with *Grunbeck* in looking at what the statute expressly says, regardless of its impact during a short period of the loan. Once again, there is no departure from accepted norms of statutory interpretation, no conflict with any other decisions of this Court or other courts of appeal, and therefore no reason why this petition should be granted.

III. The opinion below did not abandon the doctrine of administrative deference; it simply analyzed it in a manner adverse to Quicken Loans.

Once again, it must be noted that Quicken Loans is seeking to attack not the opinion below, and not even the *Wells Fargo* opinion; rather, this point about administrative deference tries to reach back to the 1996 *Grunbeck* decision, 74 F.3d 331. Regardless, Quicken Loans errs

when it claims that the Ninth Circuit decision below abandons administrative deference because it "does not agree with it." In the opinion below, the Ninth Circuit did not cite any part of *Grunbeck* criticizing any aspect of the Opinion Letter of the Federal Home Loan Bank Board ("FHLBB", now OTS) at issue. The footnote cited by petitioner from *Wells Fargo* reads as follows:

> For reasons cited by *Grunbeck*, Quicken's argument that we should defer to the interpretation of the federal Office of Thrift Supervision is deficient. *See Grunbeck*, 74 F.3d at 336 ("Where Congress has spoken directly to the issue, an interpretation rendered by the agency responsible for administering the statute is entitled to no special deference." (citing *Chevron USA v. Natural Resources Defense Council*, 467 U.S. 837, 842 (1984)).

Wells Fargo, 419 F.3d at 969, n.27. Both *Wells Fargo* and *Grunbeck* make the point that the relevant section of the DIDMCA ("expressly limiting the rate or amount of interest") is clear and succinct, *i.e.*, that "Congress has spoken directly to the issue." The much cited and discussed notion of "*Chevron* deference" applies only in opposite situations, *i.e.*, when the statute is ambiguous. *Chevron*, 467 U.S. at 842-844.

Quicken Loans cites *Auer v. Robbins*, 519 U.S. 452, 117 S.Ct. 905 (1997), for the proposition that OTS' interpretation of its regulation should be controlling. However, *Auer* granted deference to an opinion in an *amicus curiae* brief of the Secretary of Labor precisely because "Congress has not directly spoken to the precise question at issue . . ." *Id.*, at 457, quoting from *Chevron*. The theory of *Chevron* is that Congress delegates to agencies the power to make

rules to fill gaps in statutes. But there is no gap in the DIDMCA on the relevant issue. In *Christensen v. Harris County*, 529 U.S. 576, 586-587, 120 S.Ct. 1655 (2000), this Court reaffirmed that interpretations "such as those in opinion letters – like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law – do not warrant *Chevron*-style deference."

Even assuming *arguendo* that the opinion of the FHLBB were entitled to some deference, it is not applicable or relevant to the issues in this case. Quicken's characterization notwithstanding, the Maryland statute analyzed by FHLBB's General Counsel simply prohibited lenders from "requir(ing) payment of any interest in advance except any points permitted under this subtitle." Md. Com. Law Code Ann. § 12-103(b)(i)(vi). This bears no resemblance, and has no analogy, to the California Per Diem Statutes, which simply require recordation before the charging of interest. Therefore, the Opinion Letter for which Quicken urges such deference is irrelevant to the statutes at issue in this case. What is relevant is that two different circuits (in *Wells Fargo* and in *Grunbeck*) have held the language of DIDMCA ("expressly limiting the rate or amount of interest. . . . ") to be clear and unambiguous, without the need to defer to agency interpretations or opinions. This precludes the application of *Chevron* deference under any circumstances, and there is no reason to grant review on this basis.

IV. Contrary to Quicken Loans' assertions, the petition presents no important issues complementary to issues pending before this Court.

Quicken Loans asserts that the issue of how much deference to give to the cited FHLBB Opinion Letter is somehow complementary to the issues raised by *Watters v. Wachovia Bank, N.A.*, 431 F.3d 556 (6th Cir. 2005), cert. granted, 126 S.Ct. 2900 (2006). In *Watters*, the Office of the Comptroller of the Currency ("OCC") promulgated various regulations, including one (12 C.F.R. § 7.4006) stating that state laws applying to national banks (i.e., non-state chartered banks) applied equally to national bank operating subsidiaries. This had the claimed effect of exempting operating subsidiaries from certain state regulatory systems, because their parent national banks were exempt.

The Sixth Circuit held that that the regulations were entitled to *Chevron* deference.[6] The crucial point, however, is that the OCC was held to have promulgated its regulations under express Congressional authority; furthermore, the OCC was held to be using that authority to define the "incidental powers" of national banks beyond those enumerated in the statute. Regardless of how *Watters* is ever resolved, the instant case does not raise a related or "complementary" issue. When applied to this case, the FHLBB Opinion Letter does not address a matter on

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[6] The issue was decided similarly against the state regulator, i.e., Respondent herein, in *Wells Fargo Bank v. Boutris*, 419 F.3d 949 (9th Cir. 2005), already often cited in the Petition and this response. However, the issue of preemption by the National Bank Act and the OCC's regulations was decided wholly separately from the DIDMCA preemption issue, on which Respondent actually prevailed.

which Congress has been silent, or on which there is ambiguity. Quite the contrary; here, both the opinion below, and the *Grunbeck* decision it follows, held the statute (DIDMCA) to be clear in confining its preemptive effect to state laws ***expressly*** limiting the rate or amount of interest, and both decisions found that the state laws did not do that. As we have previously pointed out, there is actually no circuit split on the Parity Act issue, either, so as to warrant review by this Court.

Essentially, Quicken Loans is simply repeating its argument about deference to the FHLBB, but this time seeking to attach it to an issue on which this Court has granted *certiorari*. In reality, the opinion below has no bearing on the issues in *Watters*, and there is no reason to grant review on this basis.

V. There has been no "evisceration" of federal preemption, because the federal statutes at issue do not assert complete preemption of an entire field.

Quicken Loans lastly takes up a clarion call against alleged "evisceration" of federal preemption and alleged "balkanization" of the mortgage loan market. Respondent urges that Petitioner's zeal is misplaced when it chooses to defend these two statutes on such grounds.

At the risk of repetition, the portion of the DIDMCA at issue here raises a single and narrow issue: whether the Per Diem Statutes "expressly limit the rate or amount of interest." 12 U.S.C. § 1735f-7a(a)(1). Even the OTS (successor to the FHLBB) does not assert that the DIDMCA completely preempts state laws. See, e.g., 12 C.F.R. § 590.3(c): "Nothing in this section preempts limitations in

state laws on prepayment charges, attorneys' fees, late charges or other provisions designed to protect borrowers." The limited purpose of DIDMCA was discussed at length in *Smith v. Fidelity Consumer Discount Co.*, 898 F.2d 907 (3d Cir. 1989). The court provided the following analysis of historical context and intent:

> "DIDMCA was passed at a time when inflation and interest rates were soaring; in this context, state usury laws decreased the availability of home mortgage loans and hindered the ability of financial institutions to pay market rates of interest to depositors since usury laws limited them to lending at rates well below those that the market would have dictated. Thus, the Senate Report that accompanied the bill containing what became § 501 of DIDMCA found:
>
> That where state usury laws require mortgage rates below market levels of interest, mortgage funds in those states will not be readily available and those funds will flow to other states where market yields are readily available. This artificial disruption of funds availability not only is harmful to potential homebuyers in states with such usury laws, it also frustrates national housing policies and programs. . . .
>
> The committee believes that this limited modification in state usury laws will enhance the stability and viability of our Nation's financial system and is needed to facilitate a national housing policy and the functioning of a national secondary market in mortgage lending.
>
> In addition to the adverse effects of usury ceilings on credit availability, mortgage rate ceilings must be removed if savings and loan institutions, as directed by other provisions of [the Act], are to

> begin to pay market rates of interest on savings deposits. Without enhancing the ability of institutions to achieve market rates on both sides of their balance sheets, the stability and continued viability of our nation's financial system would not be assured. Thus, Federal preemption of State usury ceilings would not only promote national home financing objectives but would provide the resources with which savers could be paid more interest on their savings accounts."

Smith v. Fidelity Consumer Discount Co., 898 F.2d at 911 (All emphases added). It is clear, then, that the DIDMCA is *not* an example of Congress attempting to completely occupy a field, but rather addressing a specific problem in a limited manner. The Ninth Circuit opinion below simply applies one clear phrase of its language ("expressly limiting . . . ") in a manner consistent with other state and federal case authorities and consistent with the federal statutory scheme.

As to the Parity Act, the opinion below achieves the same limited result. The Parity Act does not purport to completely preempt state laws regarding non-federally chartered lenders (such as Quicken Loans). Even the OTS, to whom Quicken Loans elsewhere urges such deference, "has never identified its preemption rules as applicable to state housing creditors under AMTPA." 67 Fed. Reg. 60542, 60544 (2002). Where state laws are directed at regulating all mortgage transactions and are not directed at restricting alternative mortgage transactions, the OTS "is reluctant to encroach upon this state authority. . . . " *Id.* It is therefore simply incorrect for Quicken Loans to contend that the opinion below "eviscerates" federal

preemption, when in fact no such preemption is intended by the statutes or by the agency administering them.

CONCLUSION

The Petition does not establish any cogent reasons why this Court should grant review. There are no circuit splits and no departures from appropriate statutory interpretation. The opinion below properly applies the law regarding administrative deference, and there is no damage being done to the accepted boundaries of federal preemption. Respondent urges the Court to deny this petition.

Respectfully submitted,

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APPENDIX 1

67 FR 60542-01

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision (OTS)

12 CFR Parts 560, 590, and 591

Alternative Mortgage Transaction Parity Act; Preemption

DATE: Thursday, September 26, 2002

[60542]

ACTION: Final rule.

SUMMARY: The Alternative Mortgage Transaction Parity Act (AMTPA) authorizes state chartered housing creditors to make, purchase, and enforce alternative mortgage transactions without regard to any state constitution, law, or regulation. To rely on AMTPA, certain state chartered housing creditors must comply with regulations on alternative mortgage transactions issued by the Office of Thrift Supervision (OTS). In today's rulemaking, OTS revises its rules identifying the OTS regulations that apply under AMTPA. OTS will no longer identify its regulations on prepayments and late charges for state chartered housing creditors.

OTS is also revising its limits on the amount of late charges that may be assessed on loans secured by first liens on residential manufactured homes under part 590, which addresses the preemption of state usury laws. In addition, OTS is making a minor technical change to the definition of reverse mortgage in part 591, which addresses the preemption of state due-on-sale laws.

EFFECTIVE DATE: January 1, 2003.

FOR FURTHER INFORMATION CONTACT: Theresa Stark, Senior Project Manager, Compliance Policy, (202) 906-7054; Karen Osterloh, Special Counsel, Regulations and Legislation Division, (202) 906-6639, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

I. Alternative Mortgage Transaction Parity Act Regulations (§ 560.220)

The Alternative Mortgage Transaction Parity Act (AMTPA)[1] permits state chartered housing creditors[2] to make, purchase, and enforce alternative mortgage transactions if the creditors comply with regulations governing such transactions issued by federal regulators. AMTPA applies to loans with any alternative payment features that vary from conventional fixed-rate, fixed-term mortgage loans, such as variable rates, balloon payments, or call features. It allows state chartered housing creditors to engage in alternative mortgage transactions notwithstanding "any State constitution, law, or regulation," provided the transactions are made in conformity with

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[1] 12 U.S.C. 3801 *et seq.*

[2] A "housing creditor" is a depository institution, a lender approved by the Secretary of Housing and Urban Development for participation in certain mortgage insurance programs, "any person who regularly makes loans, credit sales or advances secured by interests in properties referred to in [AMTPA]; or * * * any transferee of any of them." To qualify as a state housing creditor and take advantage of preemption, AMTPA specifically provides that the creditor must be "licensed under applicable State law and [remain or become] subject to the applicable regulatory requirements and enforcement mechanisms provided by State law." 12 U.S.C. 3802(2).

regulations issued by one of three federal regulators.[3] Housing creditors, other than state chartered [60543] commercial banks and state chartered credit unions, that wish to make an alternative mortgage transaction under the authority of AMTPA, must comply with OTS regulations. State chartered commercial banks and state chartered credit unions must comply with regulations of the Office of the Comptroller of the Currency (OCC) and the National Credit Union Administration (NCUA), respectively.[4]

AMTPA directed the Federal Home Loan Bank Board (Bank Board), OTS's predecessor agency, OCC, and NCUA to identify, describe, and publish those portions of their regulations that are inappropriate for, and thus inapplicable to, their respective state chartered housing creditors.[5] The identified regulations are enforced by each state housing creditor's applicable state regulator.

Currently, OTS's regulation at § 560.220 identifies the following regulations as appropriate for, and applicable to, state housing creditors:

- § 560.33. This reference permits state housing creditors to impose late charges for any delinquent periodic payment and sets out certain limitations on the assessment of such late charges.

- § 560.34. This reference permits state housing creditors to impose a prepayment penalty and indicates how prepayments must be applied.

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[3] 12 U.S.C. 3803(c).

[4] 12 U.S.C. 3803(a).

[5] Section 807(b) of Pub. L. 97-320 (1982).

- § 560.35. This section addresses adjustments to interest rate, adjustments to the payment and loan balance, and the use of indices.
- § 560.210. This reference requires state housing creditors to provide initial disclosures and adjustment notices for variable rate transactions.

Housing creditors must comply with these requirements to obtain the benefit of AMTPA's preemption of state laws. All other OTS regulations are inappropriate and inapplicable to state housing creditors.

On April 5, 2000, OTS published an advance notice of proposed rulemaking (ANPR) entitled "Responsible Alternative Mortgage Lending."[6] The ANPR sought public comment on various questions in connection with a review of mortgage lending regulations, including comments on possible amendments to § 560.220.

On April 25, 2002, OTS issued a notice of proposed rulemaking (NPRM).[7] OTS proposed to delete the late charge and prepayment rules (§§ 560.33 and 560.34) from the list of regulations that apply to state housing creditors under AMTPA. OTS proposed to continue to identify the other two rules (§§ 560.35 and 560.210) as appropriate and applicable for state housing creditors.

OTS received 298 comments on the proposed rule and 293 of these commenters addressed changes to AMTPA provisions. The commenters were equally divided between

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[6] 65 FR 17811 (Apr. 5, 2000).

[7] 67 FR 20468 (Apr. 25, 2002).

support and opposition for the rule. About three-quarters of the commenters filed one of five form letters.

A. OTS Authority Under AMTPA

1. Background

Congress enacted AMTPA in 1982 to stimulate credit in an unusually high interest rate environment by encouraging variable rate mortgages and other creative financing. In hearings before the Senate in 1981, mortgage bankers testified that statutes in 26 states barred state chartered mortgage bankers and lending institutions from originating alternative mortgage loans, or imposed significantly higher restrictions on such loans than applied to federally chartered lenders operating under federal regulations.

Congress incorporated this factual background at 12 U.S.C. 3801(a). Congress found that increasingly volatile and dynamic changes in interest rates had seriously impaired the ability of housing creditors to provide consumers with fixed-term, fixed-rate credit secured by interests in real property, and that alternative mortgage transactions were essential to an adequate supply of credit. AMTPA also noted that OCC, NCUA, and OTS had recognized the importance of alternative mortgage transactions and had adopted "regulations authorizing federally chartered depository institutions to engage in alternative mortgage financing." AMTPA indicated that:

> It is the purpose of this chapter to eliminate the discriminatory impact that those regulations have upon nonfederally chartered housing creditors and provide them with parity with federally chartered institutions by authorizing all housing

> creditors to make, purchase, and enforce alternative mortgage transactions so long as the transactions are in conformity with the regulations issued by the Federal agencies. 12 U.S.C. 3801(b).

Section 3803(a) states that state housing creditors may comply with regulations governing alternative mortgage transactions issued by NCUA, OCC, or OTS. Section 807(b) of AMTPA directs the three federal regulators to identify, describe, and publish those portions or provisions of their respective regulations that are "inappropriate for (and thus inapplicable to)" nonfederally chartered housing creditors.

Apart from references to federal regulations governing alternative mortgage transactions and regulations authorizing federally chartered lenders to engage in alternative mortgage transactions, neither the statute nor the legislative history details how the three federal agencies are to exercise their authority under section 807(b). For example, AMTPA and the legislative history do not reference or provide examples of specific types of regulations that the agencies should identify for state housing creditors.

As a result of this inconclusive direction, OTS and the Bank Board have wrestled with the proper scope of the identification of regulations for state housing creditors under AMTPA. At times, the agency has taken a narrow view of AMTPA and its legislative history. For example, the Bank Board initially identified as appropriate and applicable only those regulations that "describe and define" alternative mortgage transactions and did not identify regulations intended for the general supervision of federal savings associations. As a result, the Bank Board declined to identify rules that applied to loans generally

(as distinguished from rules that bear directly on the unique features of alternative mortgage loans).[8]

In 1996, however, OTS reviewed its AMTPA authority and identified two general lending rules – the prepayment and late charge provisions at issue in this rulemaking.[9] The apparent rationale, contained in a contemporaneous legal opinion, but not in the rulemaking, was the conclusion that state housing creditors would be "disadvantaged vis-[agrave]-vis federal thrifts" if they were required to comply with state laws restricting prepayment penalties and late charges.[10] Even the contemporaneous legal opinion, however, conceded that the state laws on these subjects fell somewhere between laws clearly preempted by AMTPA (state laws barring variable rate mortgage loan transactions) and laws clearly not preempted (state laws governing liens and foreclosures).

NCUA and OCC regulations also reflect various interpretations of the scope of section 807(b) of AMTPA. NCUA has interpreted section 807(b) to permit the identification of all of its lending regulations as applicable to alternative mortgage transactions by state chartered credit unions. These mortgage regulations address such matters as the term of the loan; **[60544]** requirements governing security instruments, notes, and liens; due-on-sale provisions; and assumptions. NCUA rules specifically preempt state laws addressing certain areas. 12 CFR 701.21. OCC, on the other hand, has identified as

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[8] 47 FR 51732 (Nov. 17, 1982) and 48 FR 23032, 23053 (May 23, 1983).

[9] 61 FR 50951 (Sept. 30, 1996).

[10] OTS Op. Chief Counsel (Apr. 30, 1996).

applicable for state commercial banks a narrow band of rules. These rules: define adjustable rate mortgages (ARMs); state that ARMS may be made, sold, purchased, participated in, or otherwise dealt in without regard to any state law limitation on those activities; authorize certain indices; and specifically allow prepayment fees. 12 CFR part 34, subpart B.

As these various approaches illustrate, section 807(b) is susceptible to a number of interpretations. Each of the agencies has exercised broad discretion in its identification of appropriate regulations under AMTPA and has struck a different balance depending on its applicable statutory and regulatory scheme. Under the current rules, each of the three agencies has advanced a different interpretation of its responsibilities under section 807(b) of AMTPA.

2. OTS's Approach

In the NPRM, OTS reexamined its 1996 interpretation. OTS noted that the purpose of AMTPA was to enable all housing creditors to provide credit through alternative mortgages and to preempt state laws that would prevent that type of credit. OTS found that its regulations governing adjustments to the interest rate, adjustments to the payment and loan balance, the use of indices, initial disclosures, and adjustment notices were essential or intrinsic to the ability of state housing creditors to continue to provide alternative mortgage transactions. To provide parity with federal thrifts, OTS proposed to continue to identify §§ 560.35 and 560.210 for state housing creditors.

On the other hand, OTS tentatively noted, upon further reflection, that the prepayment and late fee

provisions were not essential or intrinsic to the ability to offer alternative mortgages. Rather, these regulations apply to real estate lending in general and are part of the broader regulatory scheme governing the lending operations of thrifts. OTS noted that one of the congressional findings underlying AMTPA was that the various federal regulators had adopted regulations authorizing federal institutions to offer alternative mortgages, and that the purpose of AMTPA was to eliminate the discriminatory impact of those regulations. OTS tentatively found that its regulations on prepayments and late fees were not adopted to enable federal thrifts to engage in alternative mortgage financing, but rather to permit federal thrifts to operate safely and soundly under a uniform federal scheme. *See* 12 CFR 560.2(a). Therefore, OTS tentatively concluded that these regulations did not offer a basis for claiming discriminatory treatment or were not needed to provide parity with federally chartered institutions. Accordingly, OTS tentatively concluded that there was no basis to distinguish prepayment and late charge provisions from other general lending rules and proposed to delete the two provisions from the list of identified rules for state housing creditors. As we explain in this statement of supplementary information, after reviewing the comments and further considering the issues, OTS adopts these findings and conclusions.

3. Comments on OTS's Approach

Several commenters argued that if AMTPA is to be given its proper effect, state housing creditors should be governed by the same regulations that address alternative mortgage transactions by federal savings associations. According to commenters, these rules include § 560.2(a),

which states OTS's intent to occupy the entire field of lending regulation for federal savings associations in preemption of state law, and § 560.2(b), which expressly preempts state laws that address such matters as private mortgage insurance requirements, loan-to-value ratios, terms of credit, loan-related fees (including late charges and prepayment penalties), access to credit reports, disclosures, and advertising laws.

OTS has never identified its preemption rules as applicable to state housing creditors under AMTPA. While commenters argued that the failure to apply these preemptive regulations would disadvantage state housing creditors vis-[agrave]-vis federal thrifts, OTS believes that this position would lead to an inappropriate result under its regulatory framework.

To enhance safety and soundness and to enable federal savings associations to conduct their operations in accordance with best practices, OTS has occupied the entire field of lending regulation for federal thrifts and has given federal savings associations the maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme. *See* 12 CFR 560.2(a). This complex uniform regulatory scheme benefits federal thrifts by preempting most state laws that otherwise would impose on federal savings associations different regulatory requirements from state-to-state. The system, however, also imposes various obligations on federal savings associations. For example, thrifts must comply with an array of regulatory limitations designed to ensure that their mortgage lending operations are conducted in a safe and sound manner. These limitations include appraisal requirements, real estate lending standards, underwriting guidelines, limits on loans to one borrower, and documentation

requirements. Thrifts are also subject to regular examination, supervision, and enforcement of their lending activities.

OTS does not believe that it may impose these concomitant obligations on state housing creditors in this rulemaking given the instructions in the legislative history that it was not Congress' intent to place state housing creditors under the supervision of the federal agencies.[11] However, preemption under § 560.2, without the application of the related duties, would lead to an unreasonable regulatory result, *i.e.*, the perverse situation where state housing creditors could engage in mortgage lending – an area that is traditionally highly regulated – unfettered by most state or federal restrictions, thereby creating a regulatory vacuum. Accordingly, OTS declines to identify its preemption rules as applicable to state housing creditors.

Other general lending rules, such as §§ 560.33 and 560.34, are also a part of the broader regulatory scheme governing OTS supervision of the lending operations of federal thrifts. The states have, to a greater or lesser degree, adopted laws and regulations similarly designed to supervise the lending operations of state housing creditors. States that restrict prepayment penalties and late charges usually apply those restrictions to all real estate loans, not

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[11] Sen. Rep. 97-463, at 55 (1982). This interpretation is also contrary to other expressions of congressional intent, which left room for state action by specifically reserving specific areas to the states. 12 U.S.C. 3802(2), for example, indicates that state housing creditors must comply with applicable state licensing requirements and must remain or become subject to the applicable regulatory requirements and enforcement mechanisms provided by state law.

just to alternative mortgage transactions. As a result, the state laws in these areas are not directed at restricting alternative mortgage transactions, but in regulating mortgage transactions in general. OTS is reluctant to encroach upon this state authority, given the cited statutory direction and the statements of legislative intent.

For these reasons, OTS declines to identify its rules preempting state lending regulations or any other rule **[60545]** that applies to real estate lending in general. Rather, OTS will identify only those regulations that OTS deems to be intrinsic to the ability to offer alternative loans.[12]

A number of commenters alleged that this interpretation of AMTPA would subject state housing creditors to state laws on prepayments and late charges while federal thrifts would remain subject to more permissive OTS regulations in these areas. As a result, these commenters argued that the proposed rule is inconsistent with the twin purposes of AMTPA – the elimination of discriminatory impact that federal regulations have on state housing creditors and the promotion of parity for state housing creditors. Specifically, commenters speculated that the proposed rule would discriminate against state housing

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[12] One commenter warned that this focus could undermine the broad preemption available for federal thrifts, *i.e.*, that state law may be preempted for federal thrifts only when preemption is "intrinsic" to the effectuation of a federal policy or goal. Other commenters sought assurance that the final rule would not erode or impair the scope of preemption available to, or the lending powers of, federal savings associations under the Home Owners' Loan Act (HOLA). This rule addresses OTS authority to identify rules for state housing creditors under AMTPA and has no impact on preemption available to, or the lending powers of, federal thrifts under the HOLA. The preemption principles under the HOLA are well settled. *See e.g.*, 12 CFR 545.2, 557.11, and 560.2; and OTS Op. Chief Counsel (Nov. 22, 1999).

creditors vis-[agrave]-vis federal savings associations in the following ways:

- Limit the range of products offered by state housing creditors. Some state housing creditors would no longer be able to offer lower rates to consumers who agree to take a loan with a prepayment penalty. In addition, restrictions on late charges would deny lenders flexibility in loan pricing and prohibit lenders from placing the cost of late payments on delinquent borrowers.

- Increase compliance costs, risk of document error, and litigation risk. Rather than complying with uniform OTS rules, creditors with multi-state operations would have to comply with inconsistent state and local laws.

- Reduce the ability to minimize prepayment risk. Prepayment penalties protect state housing creditors (and secondary market purchasers) from extreme changes in their portfolios.

- Reduce the value of their loans in the secondary market. Investors will be less able to protect against prepayment risk, and will incur additional due diligence costs (and risks) to review pools against widely varying state law. These costs will be passed on to state housing creditors. The secondary market also may have to create separate pools for federally chartered lenders and state chartered lenders to accommodate these differences.

Commenters also speculated that some lenders may choose not to offer alternative mortgage transactions in jurisdictions with restrictive laws, may cease all lending operations within those jurisdictions, or exit the industry entirely. This reduced competition, they argue, would reduce the availability of affordable credit to consumers contrary to the goals of AMTPA.

Contrary to commenters' speculation, historical evidence indicates that the final rule should not have a significant detrimental effect on state housing creditors' ability to compete against federal thrifts in the alternative mortgage market. State housing creditors functioned for 14 years (1982-1996) without applying OTS regulations on late charges and prepayments. While various prepayment regulations were applicable during this period, federal thrifts were relatively free to impose prepayment penalties since 1983.[13] Additionally, the regulations on late charges have not changed substantially during this period, other than to eliminate limitations on the amount of the late

[13] Until May 23, 1983, federal savings associations were permitted to impose prepayment penalties under limited circumstances. *See* 12 CFR 545.8-5(b) (1983) summarized below at note 19. On May 23, 1983, the Bank Board changed this rule to permit a federal savings association to impose prepayment penalties as provided in the loan contract. Penalties on loans secured by owner-occupied homes, however, were prohibited for a 90-day period following the issuance of a notice of adjustment of interest rate, payment balance, or term to maturity. 12 CFR 545.34(c) (1984). In 1993, OTS removed even these limited restrictions and allowed federal thrifts to impose prepayment penalties at any time and in any amount authorized in the loan contract for both adjustable rate and fixed rate loans. 58 FR 4308 (Jan. 14, 1993). This rule is now codified at 12 CFR 560.34 (2002).

charge.[14] Accordingly, OTS has concluded that these provisions are not essential for parity.

OTS also notes that state housing creditors were vigorous competitors in mortgage lending throughout this time period. While relative market share in the alternative mortgage market is not available, OTS does have information regarding the relative participation in the one- to four-family mortgage market. In 1982, commercial banks and thrifts dominated this market by originating approximately 66.0 percent of one- to four-family mortgages. Mortgage companies' market share was significantly smaller at 28.9 percent of the market. By 1996, when OTS changed its AMTPA rules, these positions had reversed with mortgage companies originating 56.8 percent and commercial banks and thrifts originating 42.5 percent of all one- to four-family mortgages.[15]

Moreover, it is not clear that Congress viewed prepayment penalties and late charges as essential to parity. Neither AMTPA nor its legislative history provides any useful guidance concerning this issue. However, if Congress had viewed these provisions as essential to parity, it is unlikely that Congress would have adopted the statutory scheme found in AMTPA. As noted above, AMTPA does not place all state housing creditors within the jurisdiction of one federal regulator, but assigns state housing creditors to three federal agencies in a way that

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[14] *Compare* 12 CFR 545.8-3(e) (1983) with 12 CFR 560.33 (2002).

[15] This information was obtained on the Mortgage Bankers' Association's Web site, which indicates that its source was a HUD Survey of Mortgage Lending Activity discontinued in 1998. OTS notes that at least one commenter asserts that state housing creditors now originate approximately 80 percent of all mortgages.

"recogniz[es] traditional industry lines."[16] When AMTPA was enacted, however, NCUA, OCC, and the Bank Board had different requirements regarding prepayment penalties. Congress banned federal credit unions from imposing prepayment penalties, which suggests that, at least for credit unions, Congress recognized that prepayment penalties were not essential to the ability to make, purchase, or enforce alternative mortgage transactions.[17] OCC regulations, on the other hand, permitted national banks to impose prepayment penalties on ARMs until 30 days prior to the first scheduled interest rate adjustment date.[18] Bank Board regulations permitted federal savings associations to impose prepayment penalties on alternative mortgage transactions under other limited circumstances.[19] If Congress had **[60546]** viewed the regulation of prepayment penalties as essential to parity, it is unlikely that Congress would have imposed a regulatory scheme that, at the time of enactment, ensured different treatment among the various state creditors.

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APPENDIX 2

Md. COMMERCIAL LAW Code Ann. § 12-103 (1986)

§ 12-103. Other permitted rates of interest; licensing requirements

(b) Loans secured by residential real property; licensing requirements. –

(1) A lender may charge interest at any effective rate of simple interest on the unpaid principal balance of a loan if: . . .

(vi) The lender does not require payment of any interest in advance except any points permitted under this subtitle.

APPENDIX 3

12 CFR 7.4006

§ 7.4006 Applicability of State law to national bank operating subsidiaries.

Unless otherwise provided by Federal law or OCC regulation, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank.